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JAN 11 1999
FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY

January 11, 1999

Magalie Roman Salas
Secretary
Federal Communications Commission
1919 M Street, N.W., Room 522
Washington, D.C. 20554

Re: CC Docket 96-149
Petition for Reconsideration of the National Telephone Cooperative Association
Written Ex Parte filing

Dear Ms. Salas:

Attached is a copy of a letter delivered today to Andrea Kearney in the Commission's Common Carrier Bureau concerning the above proceeding.

Please direct any questions to me.

Sincerely yours,

David Cosson

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FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY

January 11, 1999

Andrea M. Kearney
Policy and Program Planning Division
Common Carrier Bureau
Federal Communications Commission
1919 M Street, N.W.
Washington, D.C. 20554

Re: CC Docket 96-149
Petition for Reconsideration of the National Telephone Cooperative Association

Dear Ms. Kearney:

Pending before the Commission are several Petitions for Reconsideration of the requirement adopted in the *LEC Classification Order* that independent LECs must provide in-region, interstate, interexchange services through a separate affiliate.[1] In support of the Petition of the National Telephone Cooperative Association, I have previously provided information explaining that the separate affiliate requirement will have adverse tax consequences for some telephone cooperatives because they would be prevented from including the interstate interexchange revenue in their member income calculation.

In addition, at the time of our previous meeting, I reported that the Internal Revenue Service (IRS) was expected to require a cooperative to treat the gross revenues of a subsidiary as non-member income. The IRS has recently decided to reconsider that conclusion. A copy of the IRS correspondence is attached. No date is given as to when this review will be completed or whether the decision will be favorable or unfavorable.

If the IRS does change its position with regard to the gross revenues of subsidiaries, the first adverse effect of the Commission's rules will remain in that cooperatives will still be unable to count toll revenues generated by their members as member income if the members must be served through a subsidiary.

[1] *LEC Classification Order*, 12 FCC Rcd 15756 (1997).

If you have any questions on this matter, please do not hesitate to call me.

Sincerely yours

David Cosson

cc: Secretary

Attachment

DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

DEC 11 1998

The Honorable Byron L. Dorgan
United States Senate
Washington, DC 20510

Dear Senator Dorgan:

The Chief Counsel has asked that I respond to your letter of November 10, 1998, concerning Technical Advice Memorandum (TAM) 9722006 which addresses certain tax issues affecting telephone cooperatives.

Your letter expressed concern that this Technical Advice Memorandum could adversely affect the tax-exempt status of many telephone cooperatives operating in rural America, and you are concerned that the Technical Advice Memorandum is contrary to the intent of Congress in granting exemption to these entities. While the disclosure rules of Internal Revenue Code section 6103 do not permit me to discuss directly the specific taxpayer case that was the basis for this Technical Advice Memorandum, I believe the following points address the essential concerns raised in your letter:

First, as you are probably aware, a Technical Advice Memorandum is issued to establish the application of the tax law to the facts and circumstances of a particular taxpayer's case. TAM's are not intended to provide rules of general application, and section 6110(j)(3) of the Code specifically provides that they shall not be "used or cited as precedent" in the resolution of other cases.

Second, since we recognize that the issue addressed in TAM 9722006 may be a concern for a number of other taxpayers, we have begun a process of reconsidering the analysis and conclusions set forth in the TAM. We will be working in conjunction with the Office of Chief Counsel to ensure that this reconsideration takes into account not only the 1968 revenue ruling mentioned in your letter, but all the relevant authorities since that date, as well as the underlying congressional policies reflected in section 501(c)(12) of the Code. At the conclusion of this reconsideration process, we would expect to issue guidance of general application (e.g., a regulation or revenue ruling) in order to resolve the matter for all taxpayers. While I cannot now predict whether our position on the issue addressed in TAM 9722006 will change, I want to assure you that we are re-evaluating our position with an open mind in order to reach the correct interpretation of the law.

Finally, while the issue in TAM 9722006 is being reconsidered, we will instruct our agents that they should not resolve issues on audit based on the analysis and conclusion set forth in the TAM. We plan to communicate to taxpayers the decision to study this issue and the instructions to agents. To the extent that this reconsideration leads to a conclusion that is adverse to taxpayers, we will consider whether the conclusion should be applied only on a prospective basis under the authority of Internal Revenue Code section 7805(b).

While I recognize that the points set forth above are not a final answer, I hope they adequately address the concerns for the time being. If you have any further questions or concerns at this time, please feel free to contact me at (202) 622-8100, or have your staff contact Robert Harper of this office at (202) 622-7306.

Sincerely,

Marcus S. Owens
Director, Exempt Organizations
Division

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MINOT, ND 58701
701-852-0703

November 10, 1998

Stuart Brown
Chief Counsel
Internal Revenue Service
1111 Constitution Ave NW
Washington, DC 20510

Dear Stuart:

I'm writing to ask the Internal Revenue Service (IRS) to reconsider the conclusion it reached in **Technical Advice Memorandum (TAM) 9722006**, which threatens the tax-exempt status of a vast majority of telephone cooperatives operating in rural America. Congress granted the tax exemption for telephone cooperatives in 1916 because it understood the importance of delivering communication services to rural homes and businesses. Yet, the IRS interpretation in TAM 9722006 would actually imperil the tax exemption that Congress enacted to ensure that reliable, affordable and up-to-date communication services are available to our nation's rural communities. This is a mistake and I hope you will correct it.

As you know, telephone cooperatives are generally exempt from paying federal income taxes under Section 501(c)(12) of the Internal Revenue Code, so long as 85-percent of their income is collected from members. The IRS has also consistently ruled that section 501(c) organizations do not lose their exemption by operating a for-profit subsidiary.

However, TAM 9722006 departs from these long-standing principles. It concluded that gross income of a tax-exempt telephone cooperative's wholly-owned, for-profit subsidiary is immediately attributable to the parent telephone cooperative as non-member income for purposes of the 85-percent member income test, even if its subsidiary does not make a payment to the parent cooperative, is itself engaged in communication activities and is paying taxes on the profits at the subsidiary level. Broad application of this misguided TAM will be devastating for many telephone cooperatives because it will cause them to fail the 85-percent income test and, therefore, they will lose their tax-exempt status. This result is clearly in conflict with congressional intent.

As you know, TAM 9722006 was issued with respect to one particular telephone cooperative, and will take effect only for its taxable years beginning in 1999. But I've been informed that starting next year the IRS intends to apply the TAM's position on subsidiary income to all tax-exempt telephone cooperatives with operating subsidiaries. If that's true, IRS may effectively revoke the tax-exempt status that Congress has granted to telephone cooperatives.

The alarming new conclusion on subsidiary income reached in the TAM represents a radical departure from the general approach that tax exempt entities under section 501(c) do not lose their tax exemption merely because they own stock in a taxable subsidiary. And many of the subsidiaries (such as a cable television subsidiary) were formed by a parent cooperative not only for valid business reasons but because government rules require the separation of regulated and non-regulated activities.

The problems caused by the TAM are exacerbated by the IRS's self-imposed January 1, 1999 effective date for applying the subsidiary income rule because no telephone cooperatives currently have standing to challenge it in court. Moreover, I do not believe that these small rural telephone cooperatives should be forced into costly litigation due to this TAM, which clearly undermines congressional intent.

The IRS relies on a 1969 revenue ruling regarding farmer cooperatives to support its TAM position on subsidiary income. Even if the IRS believes that its 1969 revenue ruling is a correct statement of law, there is no indication that Congress ever intended that telephone cooperatives (exempt from tax under Section 501(c)(12) of the Code) should be treated the same as farmer cooperatives (exempt from tax under Section 521 of the Code) with regard to the attribution of activities of their taxable subsidiaries to the parent organization. To the contrary, sections 521 and 501(c)(12) were enacted at different times for very different purposes.

You are probably aware that in addition to the subsidiary issue, an earlier 1991 TAM mistakenly concluded that amounts received by a telephone cooperative for billing and collection services on the behalf of long distance carriers were not "communication services," but rather constituted nonmember income that was not excused from the same 85-percent member income test used for determining its tax exemption. The U.S. Tax Court expressly overturned that IRS interpretation, ruling that billing and collection service income of a telephone cooperative should not threaten its tax exemption under section 512(c)(12). In fact, the IRS recently acquiesced to the Tax Court's ruling and reversed this part of the 1991 TAM.

In light of your agency's action with regard to the 1991 TAM, and due to new threats to tax-exempt telephone cooperatives posed by TAM 9722006, I'm urging you to reconsider the subsidiary income issue. The fundamental reasons for granting the tax exemption in 1916 are just as important today. Small rural telephone cooperatives are facing enormous new financial challenges due to extraordinary technological advances and recent structural changes in their industry. And such cooperatives -- and their wholly-owned subsidiaries -- continue the important work of delivering advanced telecommunication service to rural areas where it might otherwise not exist, at the lowest possible cost to customers.

Your prompt attention to this matter is necessary. For general planning and regulatory purposes, not-for-profit telephone cooperatives will need to know prior to January 1, 1999 the consequences to the parent organizations of activities conducted by their taxable subsidiaries.

Thank you in advance for your consideration of this issue. I look forward to hearing from you soon.

Sincerely,

Byron

Byron L. Dorgan
U.S. Senator

BLD:njk

cc: Donald C. Lubick, Assistant Secretary of the Treasury (Tax Policy)
Jonathan Talisman, Deputy Assistant Secretary of the Treasury (Tax Policy)